



October 18, 2010

VIA E-MAIL: [ecmebotcomments@cftc.gov](mailto:ecmebotcomments@cftc.gov)

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Commodity Futures Trading Commission  
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Re: “ECM/EBOT Grandfather Relief,” 75 *Fed. Reg.* 56513 (September 16, 2010).

Dear Mr. Stawick:

Natural Gas Exchange Inc. (“NGX”) appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“Commission”) notice in the *Federal Register* entitled, “Orders Regarding the Treatment of Petitions Seeking Grandfather Relief for Exempt Commercial Markets and Exempt Boards of Trade,” 75 *Fed. Reg.* 56513 (September 16, 2010) (“Order”). The Order sets forth the procedures whereby exempt commercial markets (“ECMs”), operating pursuant to section 2(h)(3)-(7) of the Commodity Exchange Act, 7 U.S.C. §1 et seq. (“Act”), may petition the Commission to continue operating in accordance with those provisions of the Act, notwithstanding their being superseded by the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>1</sup> The notice in the *Federal Register* requested public comment on the Order.

### ***Natural Gas Exchange***

NGX is a trading and clearing system for energy products in the North American market and provides electronic trading, central counterparty clearing and data services to the North American natural gas, electricity and oil markets. NGX operates an electronic marketplace through which NGX contracting parties (“Participants”) may enter into (i) spot and forward physically settled natural gas and oil contracts for delivery at various Canadian and U.S. pipeline hubs and oil locations and (ii) futures and option contracts relating to natural gas, electricity and oil referencing various Canadian and U.S. pricing points.<sup>2</sup> NGX also provides clearing services through which it acts as central

<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law No. 111–203, 124 Stat. 1376 (2010) (“Dodd-Frank Act”).

<sup>2</sup> Depending upon the Commission’s rulemaking relating to key definitions, certain of these contracts might possibly also be characterized as being “swaps.”

counterparty for transactions entered into on the NGX electronic marketplace, certain transactions executed in the OTC market and transactions entered into on a third party ECM.

Since March 1, 2004, NGX has been a wholly owned subsidiary of TMX Group, Inc.<sup>3</sup> NGX's primary operations are located in Calgary, Alberta, and its lead regulator is the Alberta Securities Commission ("ASC").<sup>4</sup>

NGX notified the Commission on November 5, 2002, of its operation as an ECM. On December 12, 2008, NGX was registered by the Commission as a Derivatives Clearing Organization ("DCO"). On May 19, 2010, NGX requested that the Commission's Division of Market Oversight confirm that it will not recommend that the Commission take enforcement action against NGX, a Foreign Board of Trade ("FBOT"), in connection with direct access to the NGX market by its U.S. Participants.<sup>5</sup> That request remains pending.

On September 14, 2010, NGX filed with the Commission pursuant to section 723(c)(2)(A) of the Dodd-Frank Act and the Order, a petition for grandfather relief. If NGX's petition for relief is granted, NGX will be able to continue operation as an ECM under section 2(h)(3)-(7) of the Act as it currently is in effect for one year following the effective date of the Dodd-Frank Act.

### ***Conditions Under the Order***

Section 723(c)(2)(A) of the Dodd-Frank Act provides that within 60 days of enactment a person may submit to the Commission a petition to remain subject to section 2(h) of the Commodity Exchange Act for a period of not more than one year from the effective date of the legislation. The Commission included a number of conditions in the Order establishing the procedure for submitting such petitions for relief. The Order provides that a petitioner may "receive grandfather relief from the otherwise applicable provisions of the Dodd-Frank Act, so long as they submit both timely and acceptable grandfather relief requests and either DCM or SEF applications." Order at 56514. The condition to file a DCM or SEF application is based upon the Commission's reasoning that it

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<sup>3</sup> TMX Group operates cash and derivative markets for multiple asset classes including equities, fixed income and energy products. TMX Group is a corporation incorporated under the Business Corporations Act (Ontario) and has its head office in Toronto, Ontario. Its shares have been listed for trading on the Toronto Stock Exchange since November 2002. TMX Group is a reporting issuer in every province and territory of Canada.

<sup>4</sup> On October 9, 2008, NGX's status in Alberta changed from being an exempt exchange to a recognized exchange. In addition, NGX became a recognized clearing agency under Alberta laws.

<sup>5</sup> The request for no-action relief was made pursuant to the Commission Policy Statement entitled, "Boards of Trade Located Outside of the United States and No-Action Relief from the Requirement to Become a Designated Contract market or Derivatives Transaction Execution Facility," 71 *Fed. Reg.* 64443 (November 2, 2006.) ("Policy Statement").

expects that many entities that currently operate as ECMs or EBOTs will seek to become either SEFs or DCMs when the Commission adopts regulations implementing Dodd-Frank's requirements for those facilities.

*Id.*

NGX concurs with the fundamental reasoning behind this condition--that grandfather relief should be available only during the period that an ECM is seeking to qualify to do business in one of the available regulated market categories under the Act, as amended by the Dodd-Frank Act. In this way, and consistent with the apparent Congressional intent in providing for a one-year grandfather period, the Commission can provide for a seamless transition by existing ECM markets to the regulatory framework established by the Dodd-Frank Act. However, conditioning the granting of grandfather status to ECMs that apply for status as a swaps execution facility ("SEF") or a designated contract market ("DCM") overlooks the possibility that a market currently operating as an ECM may operate in market categories other than as a DCM or SEF under the Act, as amended. A foreign market currently operating as an ECM would have the possibility of operating in any of four market categories under the Act, as amended. Specifically, depending upon the products traded, in addition to being a DCM or SEF, a foreign market currently operating as an ECM may be a candidate for registration as an FBOT under section 4(b)(1)(A) of the Act, as amended, or for exemption from registration as an exempt foreign SEF under section 5h(g) of the Act, as amended.

### **FBOT Status**

As currently in force, section 2(h)(3)-(5) of the Act applies to any contract, agreement or transaction in an exempt commodity entered into on a principal-to-principal basis by eligible commercial entities on an electronic trading facility. Application of the section 2(h)(3) exemption does not rest upon a classification of the products trading on the facility. Thus, a facility currently relying on the section 2(h)(3) exemption could be trading spot, forward, futures, options or swaps.

Clearly, the Commission rules governing ECMs did not limit the products traded on an ECM to "swap agreements."<sup>6</sup> Indeed, Commission Rule 36.3(b)(2)(i), 17 C.F.R. §36.3(b)(2)(i), requires the ECM, on an annual basis, to identify to the Commission those agreements, contacts or transactions conducted on the electronic trading facility for which it intends in good faith to rely on the exemption in section 2(h)(3) of the Act. This notification does not require that the ECM characterize the nature of each contract, agreement or transaction by reference to a statutory or regulatory definition and it can be inferred from this requirement that a market could operate as an ECM, in reliance on the section 2(h)(3) exemption, for contracts that might be subject to a variety of characterizations under the Act and Commission rules.

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<sup>6</sup> "Swap agreements" are defined under Commission Rule 35.2, 17 C.F.R. §35.2. Had the Commission interpreted ECMs as applying only to swap agreements, it would have made reference to its existing definition of "swap agreement."

In light of the intentional ambiguity with respect to the nature of the contracts, agreements or transactions eligible for trading on an ECM, it cannot be assumed that an existing ECM only lists for trading “swaps” as defined by section 721 of the Dodd-Frank Act. Accordingly, it should not, and cannot, be assumed that when the Dodd-Frank Act becomes effective, superseding section 2(h)(3) of the Act, that an existing ECM will automatically be subject to the provisions of the new section 2h(8) requiring clearable swaps to be executed on a DCM or SEF. It is equally possible that a foreign ECM may be listing for trading contracts that would be subject to the FBOT registration provisions that the Commission may promulgate under section 4(b) of the Act, as amended. This would be true where the contracts listed by the FBOT would have been subject to the designation requirement of section 4(a) of the Act, but for the fact that they are traded on a market located outside of the U.S. Thus, a foreign market currently relying upon the section 2(h)(3) exemption and operating as an ECM might very well list for trading contracts that are subject to section 4(a) of the Act and therefore would be eligible for consideration as an FBOT.

But, as a separate matter, even if the contracts listed for trading by such a market are not contracts within the provisions of section 4(a) of the Act, but rather are “swaps” within the meaning of section 1(a)(47) of the Act, as amended, the Commission should nevertheless find that a registered FBOT<sup>7</sup> is an eligible venue for the execution of swaps. Section 2h(8) of the Act, as amended, requires that swaps that are subject to mandatory clearing also are required to be executed on a DCM or a SEF. Section 2h(8)(A)(ii) includes explicitly within the SEF category SEFs that are exempt from regulation under section 5h(f) of the Act.<sup>8</sup> The exemption from SEF registration provides that the Commission may exempt a SEF from registration with the Commission that is subject to “comparable, comprehensive supervision and regulation on a consolidated basis by . . . the appropriate governmental authorities in the home country of the facility.”<sup>9</sup>

Under the statutory scheme, DCMs are subject to greater regulation than are SEFs. Specifically, DCMs are subject to a number of regulatory requirements in excess of those applicable to SEFs--23 operating Core Principles for DCMs versus 15 for SEFs. Section 4(b) permits the Commission to register FBOTs that permit Participants direct access from the U.S. that are subject to “comparable, comprehensive supervision and regulation by the appropriate government authorities in the foreign board of trade’s home jurisdiction.” Thus, an FBOT registered by the Commission will be subject to regulation and supervision equivalent to that which applies to DCMs and greater than that which is required of either a SEF or an exempt foreign SEF.

Because an FBOT will necessarily be subject to regulation and supervision equivalent to a DCM (which is recognized as an appropriate venue for executing swaps), an FBOT too logically should be recognized as an eligible swaps execution venue. This

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<sup>7</sup> The Commission, under section 4(b)(1) of the Act may adopt rules for the registration of FBOTs that permit direct access to their markets from the U.S.

<sup>8</sup> This appears to be a mistaken section reference to the SEF exemption provision of section 5h(g) of the Act, as amended.

<sup>9</sup> Section 5h(g) of the Act, as amended by Dodd-Frank Act.

conclusion further is supported by the explicit inclusion of foreign SEFs that are subject to comprehensive, comparable regulation and supervision as eligible swap execution venues under section 2h(8) of the Act, as amended. Because a foreign SEF is subject to equivalent regulation and supervision to a domestic SEF, and because a domestic SEF is subject to fewer regulations than a DCM, it follows that a foreign SEF will be subject to less regulation in its home country than an FBOT. It is without question in the public interest to recognize registered FBOTs, which are necessarily more highly regulated than either a SEF or an exempt foreign SEF, as an acceptable swap execution venue.

### **Exempt SEF**

As discussed above, section 2h(8) envisions that SEFs that are exempt from registration under section 5h of the Act would also be eligible venues for the execution of swaps. Section 5h(g) provides that,

the Commission may exempt, conditionally or unconditionally, a swap execution facility from registration under this section if the Commission finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by . . . the appropriate governmental authorities in the home country of the facility.

Accordingly, it is possible that as part of the Commission's rule making on the registration of SEFs, it also set forth the procedure for demonstrating comparability of the regulation and supervision of a foreign regulatory authority.<sup>10</sup> By doing so, the Commission would also provide the necessary predicate for conditioning the granting of grandfather relief on an application by an ECM to be an exempt foreign SEF.

### **Conclusion**

NGX believes that the final Order should be amended to recognize the possibility that a foreign ECM, depending upon the contracts traded thereon, and as a business decision, may choose to operate in any one of four market categories under the Act, as amended—FBOT, exempt foreign SEF, DCM or SEF; and that there are two possible bases upon which a foreign market may be eligible for treatment as a FBOT. The first is that the foreign market lists for trading contracts subject to section 4(a) of the Act and qualifies as a FBOT under section 4(b) of the Act. The second would be rooted in a finding by the Commission that FBOTs are implicitly eligible as a venue for the execution of swaps because they are the equivalent of a DCM and more highly regulated than a SEF or an exempt foreign SEF.

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<sup>10</sup> Even if the Commission determines that it must undertake a rulemaking on the process for exemption as a separate rulemaking and determines that it will not promulgate such rules by the July, 2011 effective date, the grandfather period extends for one year following the effective date. Accordingly, the Commission could include exempt SEFs within the Order in the expectation that it would complete necessary rulemaking following the effective date.

It follows that the Commission should amend its Order to make clear that the Petition by an Exempt Commercial Market for grandfather relief, timely filed, will extend for as long as the ECM has pending before the Commission a bona fide application for registration as an FBOT or a SEF, designation as a contract market or recognition as an exempt foreign SEF. This is particularly important to avoid the possibility that the Commission inadvertently forces ECMs to file for recognition as a DCM or SEF, when other market categories under the Act apply, and may even be the more appropriate choice.

In this regard, it should be noted that the Commission has not yet completed its rulemaking on key definitions under the Act.<sup>11</sup> An ECM's analysis with respect to which regulatory category is most properly applied to its market may very well depend upon the Commission's adoption of rules relating to key definitions. These include the definition of "swap," and the exemption therefrom for contracts for deferred shipment or delivery.<sup>12</sup>

NGX's comments are not predicated on a final conclusion by NGX that one of the above categories most correctly fits its particular circumstances and the contracts that it lists for trading. To the contrary, NGX is reserving judgment on how the contracts traded on the NGX market are properly classified until the Commission has completed its rulemaking on definitions. NGX respectfully suggests that the Commission do so as well.

In any event, it is clear that limiting the Order to ECMs seeking SEF or DCM status is inconsistent with market categories, such as FBOT that clearly may apply to some ECMs, such as NGX. Moreover, NGX has raised two procedural issues in need of clarification before the Commission makes a final determination on the conditions of the Order. These are whether FBOTs registered with the Commission are appropriate trading venues for swaps and the process for applying for exemption as a SEF regulated by an appropriate foreign regulator.<sup>13</sup>

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The Commission's Order takes an important first step in beginning the process of implementing the provisions of the Dodd-Frank Act. The Order, by establishing the procedure for granting grandfather relief to ECMs, helps to ensure an orderly transition for existing markets to the new statutory framework applicable to the trading of derivatives. The Commission is to be commended for providing this certainty to the market. Although NGX supports the basic tenet of the Commission's Order, that

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<sup>11</sup> The Commission on August 20, 2010, published in the *Federal Register* an Advance Notice of Proposed Rulemaking, requesting comments on key definitional terms under the Act, as amended. "Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act," 75 *Fed. Reg.* 51429 (August 20, 2010).

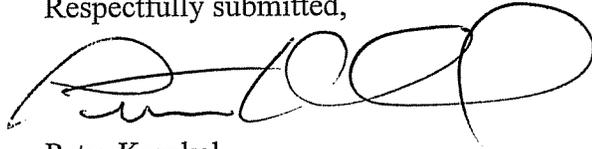
<sup>12</sup> NGX is separately filing with the Commission comments on the meaning of that definitional concept and how it might apply in the context of an electronic trading facility.

<sup>13</sup> To the extent that the Commission may not promulgate rules relating to the procedure for exemption of a SEF based upon regulation by a foreign regulatory in time for the effective date of most of the Dodd-Frank Act's provisions, the grandfather period extends for one year following the effective date.

grandfather relief should be predicated on the ECM seeking to come within a category of market recognized under the Act, as amended, based upon the above facts and analysis, it is clearly in the public interest to expand the market categories included in the Order as a condition for obtaining grandfather relief.

NGX appreciates the opportunity to comment on the Commission's Order.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Peter Krenkel', with a large, stylized flourish at the end.

Peter Krenkel,  
President and CEO